



In Case You Missed It: Illinois Grappling With Fiscal Fallout of Massively Unsustainable Pension System

Today, the House Government Operations Subcommittee will take up pension reform and begin work on a fiscally responsible plan that will create greater economic certainty for Florida's retirement system by switching to a defined contribution model.

Meanwhile, in Illinois, a state that has done little to reform its state pension system, Governor Pat Quinn is faced with choosing between funding state hospitals or paying out pension benefits to the state's retired workforce. According to a report by Reuters, "The fiscal crisis caused by pension underfunding in Illinois is so bad that some hospitals wait a year to be paid by the state for insurance claims."

Other article highlights:

- A budget report by the task force headed by former Federal Reserve Chairman Paul Volcker in October detailed a dysfunctional Illinois system lacking proper checks and balances that will end up eating away at growth and quality of life across the state. **"Illinois' past fiscal choices and future threats challenge the state's ability to meet its population's basic needs, let alone accommodate future growth,"** the report concluded.
- At the same time, teachers in Chicago's wealthy suburbs are retiring with six-figure salaries set by school districts on which pensions are calculated, and the state pays the bill. The benefits cannot be reduced, according to the state constitution.
- Illinois' pension systems are in the worst financial shape of any state at 39 percent funded when no less than 80 percent is considered healthy. State pensions are in the hole by the staggering amount of nearly \$97 billion, or \$20,000 per Illinois household and nearly four times the annual state revenue.
- The pension funding gap in Illinois has pushed the state's credit rating to the lowest of any state rated by major agencies. That raises the state's borrowing costs to such an extent that last week it had to postpone a bond sale to fund construction in the spring.



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AT A GLANCE – PROPOSED FLORIDA MODEL

- Current enrollees in the Florida Retirement System (FRS) pension plan will see no changes – **nothing changes for them.**
- Likewise, those initially enrolled in the Florida Retirement System before January 1, 2014, will continue to have a choice between the two plans.
- **Only new employees who have never participated in the FRS** (as of January 2014) will be required to enroll in a defined contribution plan (Investment Plan) as part of their employee benefit package.
- With the investment plan, the employee takes ownership of their retirement choices and the funds that are contributed into their accounts. The employee is vested in just one year (rather than 8 under the pension model) and will be able to take those funds with them should they decide to leave their employment with a Florida Retirement System employer.
- The investment plan is more suitable for today's mobile workforce. Most individuals currently entering the workforce do not plan on staying at the same job for their entire careers. Many will go from the public to private sector in various capacities during their careers and may benefit greatly from being able to roll their state retirement funds into an IRA or other retirement account.
- With the pension model, any employee that leaves FRS eligible employment before their 8-year vesting loses pension benefits accrued with the state, unless and until such time as they may decide to return to an FRS employer.

Here is the Reuters article in full:

Illinois governor to bear grim news over pension crisis

By Karen Pierog | Reuters – Tue, Feb 5, 2013

CHICAGO (Reuters) - Illinois Governor Pat Quinn, already the most unpopular governor in the nation, has his work cut out for him at his annual "state of the state" speech on Wednesday - and this time he probably won't be relying on a python named "Squeezy."

The fiscal crisis caused by pension underfunding in Illinois is so bad that some hospitals wait a year to be paid by the state for insurance claims.

At the same time, teachers in Chicago's wealthy suburbs are retiring with six-figure salaries set by school districts on which pensions are calculated, and the state pays the bill. The benefits cannot be reduced, according to the state constitution.

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amount of nearly \$97 billion, or \$20,000 per Illinois household and nearly four times the annual state revenue.

It is this increasingly nightmarish financial mess that the Democratic governor has to address in his speech to the legislature in Springfield on Wednesday.

Quinn was widely lampooned in November when he held a press conference to unveil a cartoon python called "Squeezy" in an attempt to illustrate how pension costs are squeezing funding for education and other core services.

Despite the mockery, everybody agrees the problem is serious.

"This is a horribly embarrassing situation for the citizens of Illinois that their legislature said stabilizing pensions is a top priority yet nothing comprehensive has been done in over a year," said Laurence Msall, president of the Civic Federation, a non-partisan research group backed by Chicago business.

There might be some movement afoot. Majority Democrats, who have relied for decades on labor unions for political and financial support, are showing signs of a willingness to confront organized labor.

"To date, we have received no cooperation from the labor unions representing state employees on addressing these challenges," powerful state House Speaker Michael Madigan wrote in a January 30 letter to the head of a labor coalition.

The legislature will discuss this week proposed laws to boost worker contributions to pensions, raise retirement ages, eliminate the cost-of-living adjustment for retirees for several years, and end some abuses.

Michael Carrigan, president of the Illinois AFL-CIO, said in a statement that unions are willing to make a higher contribution toward the costs of their pensions to help solve the problem. "The public employees and retirees who serve the people need and depend on the modest pensions they earn and pay into from every check."

The financial pressures to act are growing. The pension funding gap has pushed the state's credit rating to the lowest of any state rated by major agencies. That raises the state's borrowing costs to such an extent that last week it had to postpone a bond sale to fund construction in the spring.

In Illinois, a balanced state budget is an illusion, only possible through a strategy of delaying payment of bills. The backlog was \$9.3 billion at the end of fiscal 2012 and some 40 percent of this is for basic health care services such as payments to hospitals for care of poor people.

POLITICAL DYSFUNCTION

The financial crisis is not immediately apparent in the nation's third-largest city of Chicago - which still boasts pillars of the U.S. economy including the world's largest derivatives trading



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exchange, CME Group, the headquarters of Boeing and - in the suburbs - McDonald's head office.

But economic growth in President Barack Obama's home state has lagged the nation for decades, according to a national task force on state budget problems, and its unemployment rate of 8.7 percent is the sixth highest in the nation.

A budget report by the task force headed by former Federal Reserve Chairman Paul Volcker in October detailed a dysfunctional system lacking proper checks and balances that will end up eating away at growth and quality of life across the state.

"Illinois' past fiscal choices and future threats challenge the state's ability to meet its population's basic needs, let alone accommodate future growth," the report concluded. In the early 1980s, Illinois had a sterling AAA bond rating. Its standing eroded and the top rating agencies - Standard & Poor's, Moody's Investors Service and Fitch Ratings - have collectively downgraded Illinois a dozen times since 2008.

While the state is supposedly required to make annual payments to the pension systems to keep them healthy, this has routinely been ignored. The state contributed the amount required by actuarial calculations to pension systems in only one year of the last decade, according to a prospectus for the state's bond auction last week.

Another factor is that the state pays the bill for pensions of university employees and most teachers, but has little control over their salaries, which are used to calculate them. In one school district typical of the Chicago suburbs, Maine Township, over half the teachers made \$100,000 annually or more, and salaries ranged up to \$158,000 per year, according to data from the state board of education. When teachers retired last year, they were eligible for a pension of up to 75 percent of the average of the highest four consecutive years of pay, resulting in some six-figure pensions.

A huge obstacle to reform is an article of the Illinois Constitution that says any state pension is an enforceable contract and "shall not be diminished or impaired." The requirement to fund the system, by contrast, is not enforceable under the state's constitution. Unions have said they will challenge pension reforms in court, and rating agencies warn this could drag out reform for years.

Illinois also stands out among states for its strategy of delaying bill payments to balance the budget.

"In the case of Illinois, the process is much different than any other state in terms of the degree and amount and how it is used as part of the budget-balancing process," said Arturo Perez, a National Conference of State Legislatures analyst.

It takes an average of eight months for hospitals in Illinois to be paid for Medicaid health services for the poor, the Illinois Hospital Association said. Many have not been paid in a year for health services provided to state employees.



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The president of the Illinois State Medical Society points to the case of one obstetrician who treated a woman early in her pregnancy and had still not been paid after the baby's birth.

"We are getting close to the breaking point," Dr. William Werner said of the financial burden on doctors.

Some ambulance providers in the state, who by law cannot refuse to take a patient to a hospital, have reduced staff or vehicles because of delayed payments, said Andrew Thornton, treasurer of the Illinois State Ambulance Association.

"I think that in some communities (ambulance) response times have increased," Thornton said, citing anecdotal reports from members of the association.

'STATE OF STATE IS DIRE'

Quinn, who succeeded two governors who went to jail for corruption, has tried to rally support for pension reform but his efforts have been criticized as ineffectual.

He used his power to call a special session of the state legislature last summer that ended after one day with no action.

In November, Quinn had an approval rating of just 25 percent, the lowest of any governor polled by Democratic pollsters Public Policy Polling. Speaker Madigan, who has held the office for 28 of the last 30 years, is even less popular, with approval at 16 percent in an October Chicago Tribune poll.

On Wednesday, Quinn is likely to once again warn that the state's already low credit ratings could be downgraded further and he will call on lawmakers to pass pension reforms. Few are likely to disagree with the dismal report, least of all Judy Baar Topinka, the Republican state Comptroller who has the difficult task of deciding which bills the state can pay.

"I wish I could say something more optimistic, but the state of the state is dire - and it is getting worse," she said.

(Additional reporting by Greg McCune, Joanne von Alroth and Mary Wisniewski; Editing by Mary Milliken and Claudia Parsons)



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